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NEED TO STRENGTHEN AUDIT OVERSIGHT ON EXISTING AND
FUTURE BLOCK GRANT PROGRAMS (AFMD-82-25)(U) GENERAL
ACCOUNTING OFFICE WASHINGTON DC ACCOUNTING AND FINANC.

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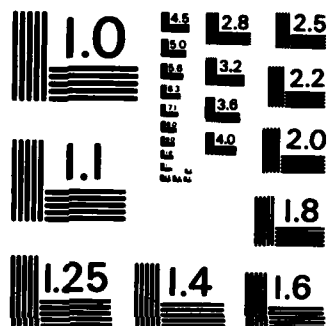
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The Honorable David Durenberger
Chairman, Subcommittee on Intergovernmental
Relations, Committee on Governmental Affairs
United States Senate

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Subject: Need to Strengthen Audit Oversight on Existing
and Future Block Grant Programs (AFMD-82-25)

Dear Mr. Chairman:

As requested by your office on October 30, 1981, this report summarizes the results of our recently completed review of the title XX social services grant program. We believe this information will be of assistance to the Subcommittee in its current deliberations on proposed legislation designed to strengthen audit oversight on existing and future block grant programs.

The objective of our review was to assess the quality and effectiveness of the States' financial management control systems in providing adequate accountability over Federal funds. Although our specific findings deal with title XX as a categorical grant program, we believe the weaknesses we identified--particularly those related to audit coverage--have a direct bearing on the issues being raised by the Subcommittee in its efforts to improve accountability and audit oversight on block grant funds for which the States have stewardship.

Title XX was selected for review because it was a State-operated grant program designed to give States and their local governments maximum flexibility in planning, implementing, managing, and administering a variety of social services programs tailored to the special needs of their own citizens. Because of the degree of flexibility inherent in the program, the cognizant Federal agency has had to rely heavily upon the States' financial management control systems for ensuring accountability over billions of dollars of program expenditures. We reviewed the grant management and administrative controls in four States with title XX awards totaling \$555.8 million in fiscal 1979. To test the effectiveness of these controls we performed detailed financial and compliance reviews of a judgment sample of 98 purchase-of-service contracts totaling \$106 million, or about 20 percent of the total value of purchase-of-service contracts awarded in the four States.

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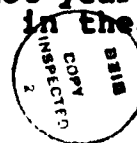
We also reviewed 51 audit reports and corresponding workpapers prepared by the State auditors and independent public accountants to determine the adequacy of audit coverage of title XX expenditures. We used the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (GAO's "yellow book" standards) as our measure of adequacy.

RESULTS OF OUR REVIEW

We found that the States' financial management and internal controls have been largely ineffective in protecting against fraud, waste, and abuse and providing proper accountability over Federal funds. For example, ~~we found~~ about \$13.2 million of improper and unjustified costs were claimed under 60 of the 98 contracts ~~we~~ reviewed. This represented about 12 percent of the total value of the contracts sampled. The problems noted included such abuses as:

- Contractors claiming reimbursement for the same costs under two separate Federal grant programs, or twice under title XX.
- Contractors billing for reimbursement on the basis of estimated rather than actual costs without making the necessary yearend adjustments to reflect actual costs.
- Contractors inflating their title XX billings by failing to offset program income (service fees paid by beneficiaries) against program costs.
- Contractors using billing rates that exceeded those agreed to in fixed unit price service contracts.
- Contractors receiving reimbursement for costs incurred prior to the execution of a service contract.
- Contractors receiving reimbursement in amounts far exceeding the contract ceiling and, in some cases, receiving retroactive contract amendments to accommodate such overruns.

Our analysis of these problems revealed that they are not isolated instances or peculiar to any one State. Almost half of the contracts reviewed in each of the four States contained problems of a financial nature, although admittedly not to the same degree of materiality. Many of the problems, furthermore, were found to exist in previous or subsequent contract years and appeared to be "the normal way of doing business" in these States.



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Finally, some of the conditions not only violated Federal regulations, but also violated the States' own policies and procedures.

Most of the improper grant practices and unauthorized or questionable costs discussed above could have been avoided through more effective State oversight and audit activities. However, weaknesses in the financial management control systems of these States allowed the abuses to go undetected. Specifically, our review disclosed that some States failed to audit or otherwise oversee the financial activities of all, or a vast majority, of their title XX contractors. Most of the unauthorized or questioned costs found during our contract review were in those States where audits were generally not being performed.

In addition, in those instances where the States did conduct audits of title XX contractors, they generally failed to meet the GAO yellow book criteria for acceptable financial and compliance auditing. Of the 51 audits reviewed, for example, 32--or 63 percent--were judged deficient when compared with these standards, and were therefore of questionable value in ensuring accountability over Federal program funds. In general, the State audits were more deficient than those conducted by independent accounting firms. Of the 35 State audits reviewed, for instance, 28 failed to review the contractors' internal controls, 21 failed to address Federal and/or State compliance issues, and 24 had inadequate documentation to support the reported findings. The only major deficiency in the independent accounting firm audits was that 8 of the 16 reviewed failed to address compliance issues.

CONCLUSIONS AND RECOMMENDATIONS

Although some of the financial and compliance deficiencies discussed herein are no longer at issue under the new title XX block grant legislation, the issues we raised on the adequacy of the States' financial management control systems directly support the need to strengthen the audit and administrative management provisions of existing and proposed block grant legislation. Clearly, the Administration's desire to decentralize the accountability function and minimize Federal intervention in selected programs in no way lessens the need for the Federal Government to establish at least some minimum criteria for proper block grant management--especially in the areas of financial and compliance oversight. Furthermore, our findings clearly show that without some mechanism for audit evaluation there is no assurance that the minimum standards will be met and proper accountability achieved.

In summary, we believe that regardless of the type of mechanism used to disburse funds and administer Federal programs, the Federal Government still has an obligation to ensure sound financial management controls over Federal funds by assessing the adequacy of State internal controls, including the adequacy of audits performed pursuant to block grant legislation, whether conducted by State or local auditors, or independent accounting firms. We believe that, as a minimum, this type of coverage is essential for meeting the Federal Government's responsibility to maintain the integrity and accountability of taxpayer funds.

Accordingly, we recommend that in the Subcommittee's deliberations on proposed amendments to the block grant cross-cutting legislation, consideration be given to:

- Expanding the audit and oversight provisions contained in the cross-cutting legislation to include all block grants under the Omnibus Budget Reconciliation Act.
- Making GAO's yellow book standards for financial and compliance audits mandatory for State, local, and independent public accountant audits of block grant programs by deleting the phrase "insofar as is practicable."
- Requiring the establishment of an audit quality review process at the Federal level to ensure that the audit organizations, reports, and the audit work itself meet the GAO yellow book standards.
- Including subrecipients under the audit requirements of the proposed amendments to the cross-cutting legislation, and clarifying the definition of subrecipients to include purchase-of-service contractors.

In making the above recommendations, it is not our intention that failure to comply with the standards would automatically result in cutoff of funds. Instead, we would recommend that the cognizant executive branch agency be given the discretion necessary to evaluate the significance of any deviation, and to take such remedial action as seems warranted under the circumstances.

As arranged with your office, we did not obtain agency comments on this report. Also, unless you publicly announce its contents earlier, we plan no further distribution of this report until 15 days from the date of the report. At that time we will send copies to interested parties and make copies available to others upon request.

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We would be happy to draft the appropriate legislative language should the Subcommittee decide to adopt our recommendations. We appreciate the opportunity to be of assistance to the Subcommittee on this most important matter. Please let us know if you have any questions or need any additional assistance.

Sincerely yours,

A handwritten signature in cursive script, reading "Charles A. Bowsher".

Comptroller General
of the United States

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